COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MOUNTAIN UTILITIES, INC. FOR:		
1. ORDER AUTHORIZING A RATE INCREASE	)	
2. INTERIM ORDER TO IMMEDIATELY IMPLEMENT ITS PROPOSED RATES ON AN EMERGENCY BASIS PURSUANT TO KRS 278.190	)	
3. ORDER APPROVING BORROWING $162,000 FROM THE COMMONWEALTH OF KENTUCKY, DEPARTMENT OF LOCAL GOVERNMENT	)	CASE NO. 9546
4. ORDER AUTHORIZING A CERTIFICATE OF CONVENIENCE AND NECESSITY TO RECONSTRUCT THE TOM'S CREEK AREA OF THE SYSTEM	)	

O R D E R

On March 31, 1986, Mountain Utilities, Inc., ("Mountain") filed for a rate increase, approval of an interim rate increase, authorization to reconstruct the Tom's Creek area, and approval of borrowing $162,000 from the Department of Local Goverment ("DLG"). The purpose of the $162,000 borrowing included the reconstruction project, refinancing the $47,572 delinquent amount on the existing DLG loan, and retiring the $52,000 loans from local banks for which the proceeds were used to pay delinquent gas purchases.

On May 12, 1986, the Commission denied Mountain's request for an interim rate increase.

The Commission received a letter dated June 16, 1986, wherein DLG notified Mountain that it would restructure the original loan by adding the delinquent payments to the end of the existing loan, and that it would loan Mountain additional funds for the reconstruction. However, DLG stated that in order to loan Mountain $52,000 to retire the loans with First Guaranty National Bank ("First Guaranty") and First Commonwealth Bank ("First Commonwealth") a personal quarantee for the $52,000 loan must be given by a stockholder so as to provide the same guarantee as currently exists on the two loans. Since none of the stockholders would give personal guarantees to DLG even though they had given such to the banks, DLG would not finance the retirement of the bank loans. Mountain, therefore, has requested that the interest expense on the two bank loans be included in the determination of revenue requirements.

In its letter of September 12, 1986, DLG stated that the Kentucky Gas System Restoration Project Account Review Board had approved an $80,000 loan for the reconstruction. According to a letter filed October 13, 1986, with the Commission, Mountain received and accepted a low bid of $78,620 for the proposed construction from Music and Underwood, Inc. This bid includes the reconstruction of the Tom's Creek portion of the System, road boring to add on an additional customer, and upgrading service to an additional 18 customers.

DLG has given approval for the additional construction and will loan Mountain the entire $80,000 to cover the cost of the construction and to help facilitate the payment of engineering fees not included in the bid price.

The road bore will add the Johnson County Regional Detention Center ("Detention Center") to the system with an estimated annual usage of 9,000 MCF.

As preparation proceeds to begin construction on the three projects Mountain is advised that it shall maintain contact with the Commission's Division of Engineering, Gas Safety Branch, and provide a construction schedule including materials for each project at least 30 days prior to beginning construction. All construction shall comply with the Commission's gas pipeline safety regulations, 807 KAR 5:022.

On August 18, 1986, the Commission issued an Order in this proceeding wherein the Commission Staff's financial report for Mountain for the period of January 1, 1984, to December 31, 1984, and the correspondence concerning this report were included as a part of the record.

The rates proposed by Mountain would produce additional revenue of $100,266, an increase of 30.33 percent over normalized test year operating revenue of $330,620, including the proposed additional customer, per the revised billing analysis.[1] Based upon the determination herein, the operating revenue of Mountain will increase by $34,710 annually over normalized test-year operating revenue, an increase of 10.5 percent.

A hearing was held in this case in the offices of the Public Service Commission, Frankfort, Kentucky, on September 11, 1986. There were no intervenors.

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1 Response, Commission's Information Request dated June 3, 1986, Item No. 35.

COMMENTARY

Mountain is a privately owned gas system and serves 511 customers in Johnson County, Kentucky. The president and major stockholder is Stephen R. Allen.

TEST PERIOD

Mountain proposed and the Commission has accepted the 12-month period ending December 31, 1985, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

Mountain proposed several adjustments to test period revenues and expenses, which are generally proper and acceptable for rate-making purposes, with the following modifications:

Gas Sales

Mountain proposed to decrease test year gas sales revenue of $298,277 by $26,148 to normalize revenues based upon the wholesale rates in effect as of November 1, 1985. Mountain erroneously used a $.0135 per dth Gas Research Charge, instead of $.0125, in effect as of November 1, 1985. In addition, Mountain did not include the revenues from the new service to the Detention Center in its calculations.

The Commission has recomputed the normalized gas sales revenues to be $326,170 utilizing existing rates including the revenue from the Dentention Center.[2]

<u>Gas Purchases</u>

Mountain proposed to increase gas purchases expense for the test year by $2,207, based upon the Kentucky West Virginia Gas Company ("Kentucky West") wholesale rates effective November 1, 1985, but did not include an adjustment for the additional customer.

Mountain experienced line losses in excess of 13 percent during the test period. In its last rate case proceeding, Case No. 8425,[3] which utilized a test period ending September 30, 1981, Mountain was experiencing line losses in excess of 28 percent. The continuing reduction of the line loss percentage resulting from the reconstruction of the Tom's Creek area, is expected to result in line losses no greater than 5 percent, which is the maximum line loss generally allowed by the Commission for rate-making purposes. Therefore, the Commission has recomputed the gas purchases expense utilizing a 5 percent line loss, the corrected average cost per MCF using the $.0125 Gas Research

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[2]

Commission normalized test year revenue	$272,618
Detention Center @ present rates	53,552
Normalized test year revenue including the Detention Center	$326,170

[3] Case No. 8425, Application of Mountain Utilities, Inc. for a Rate Increase and Authority To Borrow Certain Amounts to Apply On Its Current Indebtedness, Final Order entered July 6, 1982.

Charge per dth and the estimated gas purchases for the Detention Center, resulting in an allowed gas purchases expense of $210,468, which is an increase of $24,158 over test year actual purchased gas expense of $186,310.[4]

Maintenance of Meters

Mountain reported test year Maintenance of Meters expense of $2,250. During the test year Mountain paid E.M. Conley, a retired employee of the system, $1,800. Mountain considers a portion of this payment as informal retirement benefits. Mr. Conley presently receives some calls from customers and he relays the messages to Mountain. Since this expense cannot be separated as to the informal retirement benefits and the actual services received, the total amount is considered a discretionary expense which is not essential to the provision of gas service to Mountain's customers.[5] Therefore, the Maintenance of Meters expense has been decreased by $1,800 to a level of $450 for rate-making purposes.

Outside Services Employed

Mountain proposed to increase the Outside Services Employed expense by $5,728 to an adjusted level of $7,978. This proposed adjustment was based upon a 3-year amortization of an estimated $1,500 of legal fees associated with the rate case and a 3-year amortization of a $15,685 corrosion evaluation program.

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4 53,320 MCF ÷ 95 Percent = 56,126 MCF X $3.7499 = $210,468

5 Hearing Transcript, September 11, 1986, page 40.

Since DLG has approved additional money for Mountain through the Gas System Restoration Program, the Tom's Creek section of Mountain will soon consist of plastic pipe which should virtually eliminate the need for periodic corrosion evaluation. Mountain's current level of expense for annual maintenance requirements should be sufficient for compliance with the Commission's gas safety regulations regarding corrosion. Therefore, the proposed adjustment based upon the initiation of a corrosion control program has not been included for rate-making purposes herein. However, the Commission has allowed the 3-year amortization of the legal expenses associated with this proceeding, resulting in a $500 increase to annual operating expenses.

Transportation Expenses

Mountain reported test year transportation expenses of $4,859. The evidence reveals that items expensed during the test year totalling $711 should have been capitalized and depreciated over 3 years since these items will benefit more than one period.[6] Therefore, the test year transportation expense has been decreased by $711 to a level of $4,148 for rate-making purposes.

Depreciation Expense

Mountain proposed a $97 increase to test year depreciation expense of $25,751 to normalize the depreciation expense on assets

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Inv. No.	Music-Carter-Hughes Chevrolet	
94375	replace water pump	$122.85
85060	replace clutch	424.32
2827	replace core	163.65
		$710.82

purchased during the test year. The Commission is of the opinion that this adjustment is reasonable and has accepted it for rate-making purposes.

Mountain depreciates meters and regulators by the straight line method over 10 years. It is the Commission's opinion that meters and regulators with proper maintenance will last at least 20 years. Therefore, the remaining balances of the meters and regulators as of the beginning of the test period were depreciated over a total life of 20 years. This adjustment results in a decrease to the test year depreciation expense of $619.

In response to an information request, Mountain stated that depreciation expense of $529 had been claimed for exposed pipe unfit for use. The Commission has disallowed this amount herein.

Mountain did not propose an adjustment to reflect the depreciation on the proposed construction. This expense is both known and measurable and therefore test year depreciation expense has been increased by $2,000.[7] Thus, after considering the aforementioned adjustments, test year depreciation expense has been increased by $1,186 to a level of $26,937.

Mountain reported $755,285 of Unclassified Utility Plant per the depreciation schedule on page 24 of the application. Mountain was directed in the Commission's Staff Financial Audit dated March 13, 1986, to reclassify this account in accordance with the Uniform System of Accounts ("USoA"). Mountain is hereby directed

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7 $80,000 proposed construction ÷ 40 years = $2,000.

to reclassify the Unclassified Utility Plant and submit copies of the entries made to record this reclassification. In addition, Mountain shall extend the depreciable life of the meters and regulators as mentioned above to 20 years and submit copies of the entries made to reflect the change.

Mountain's test period revenues and expenses have been adjusted as follows:

	Test Year Actual	Adjustments	Test Year Adjusted
Operating Revenue	$302,727	$27,893	$330,620
Operating Expenses	286,424	27,653	314,077
Operating Income	$ 16,303	$ 240	$ 16,543

Interest Income

Litigation in the case of Pratt, et al., v. Mountain Utilities Company, Inc., ("Pratt Judgment") resulted in a judgment against Mountain. In settlement of the judgment, Mountain made an agreement with Frank and Lola Pratt on June 16, 1983, for payment of $75,000 as of the date of the agreement with additional payments of $30,000 and $35,000 with interest at 8 percent on July 1, 1984, and July 1, 1985, respectively.

As stated in Mountain's last rate case in the July 6, 1982, Order in Case No. 8425, the Commission is of the opinion that it would be unfair and unjust to require Mountain's customers to provide recovery of the funds needed to pay the judgment. Mountain's stockholders, therefore, shall be responsible for payment of the judgment. However, per the July 6, 1982, Order in Case No. 8425, the margin above utility operating costs and interest payments could help facilitate the payment of the judgment liability.

Mr. Allen stated during the hearing that the payment of the judgment came out of Mountain's operating funds.[8]

Since the Order in Case No. 8425 permitted payment out of the adjusted margin above utility operating costs only, for rate-making purposes, the Commission is of the opinion that for each of the years wherein a judgment payment was due, the adjusted margin should be applied towards the payment. Therefore, the difference between the adjusted margin and the actual judgment payment from operating funds should properly be treated as a receivable from stockholders and accruing interest income for rate-making purposes.

To reflect this interest income the Commission has first made a determination of the amount of money available, following the Pratt settlement or the margin after legitimate utility operating costs. The adjusted margin was determined by taking net income plus expenses paid on the Pratt settlement, less the DLG annual principal payment, less any surcharge amounts included in income, less the required escrow deposit per the DLG loan agreement. The

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8 Hearing Transcript, September 11, 1986, page 41.

adjusted margins for the years 1983, 1984, and 1985 are $57,426, $<35,069>, and $<50,245>, respectively.[9]

Second, after determining the amount of margin available to pay the Pratt Judgment, the receivable was calculated by reducing the margin by the actual amounts Mountain paid toward the Pratt settlement. This receivable was then charged interest income at the average annual treasury bill rate and accrued on an annual basis. During 1983 Mountain paid $75,000 towards the judgment while the net margin was $57,426, making the receivable from the stockholders to Mountain as of December 31, 1983, $18,332, including $758 of interest income to Mountain. Since there were negative net margins for the years 1984 and 1985, the receivable increased by the full amount of the judgment payments plus accrued interest.[10]

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	1983 Per Annual Report	1984 Per Staff Financial Audit	1985 Per Annual Report
Net Income	$<27,939>	$ 36,107	$<25,852>
Pratt Judgment Expensed (Interest & Principal)	142,821	4,000	1,400
DLG Principal Payment	<722>	<11,071>	<10,879>
Surcharge	<55,477>	<44,904>	-0-
Escrow Account	<1,257>	<19,201>	<14,914>
Adjusted Margin	$ 57,426	$<35,069>	$<50,245>

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December 31, 1983, Balance	$ 18,332
July 1984 payment	32,499
1984 Interest @ 9.58%	3,313
Balance	$ 54,144
July 1985 payment	40,722
Balance	$ 94,866

Therefore, the Commission is of the opinion test year interest income of $880 should be increased by $5,580 to reflect the interest earned from the above described receivable.[11]

<u>Interest Coverage</u>

Mountain's investment in its utility plant is financed entirely by debt, which is held by the Federal Economic Development Administration through DLG and was incurred to reconstruct the gas system. Mountain is currently $47,572 in arrears to DLG. However, DLG has agreed to refinance the delinquent amount by extending the payments on the existing loan in addition to financing the proposed $80,000 construction projects over 30 years at a 6.25 percent interest rate. Since the entire existing plant and the proposed construction is and will be financed through debt, a return on net investment is not appropriate.

Mountain proposed, and the Commission has accepted, an interest coverage of 1.5 times the average interest expense payable over the next 3-year period which will provide an adequate margin for equity growth and repayment of utility obligations considered reasonable for rate-making purposes.

Mountain reported test year interest expense of $38,844. According to the July 6, 1982, Order in Case No. 8425, Mountain

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11 December 31, 1984, Balance of receivable $54,144
1985 Interest on Balance @ 7.49%: $4,055
July 1985 payment $40,722
1985 Interest on payments
6 mos. @ 7.49% = $1,525
1985 Total Interest Expense: $5,580

was allowed a surcharge of $5.00 per month plus $.43 per MCF to pay past due gas purchases to Kentucky West. The surcharge was to be in effect for 24 months or until Mountain had collected $128,948, whichever occurred first. Mountain billed the surcharge through October 31, 1984, for 28 months and collected the total amount.

On August 22, 1985, the Commission initiated a Show Cause proceeding, Case No. 9407, to investigate the delinquent account with Kentucky West totalling $77,912.[12] During September, 1985, Mountain borrowed $52,000 from two local banks to apply towards the arrearage and agreed upon a repayment schedule for the remainder with Kentucky West. On June 5, 1986, the Commission issued an Order stating that as of May 15, 1986, Mountain had eliminated its delinquent purchased gas account and dismissed the proceeding.

Mr. Allen stated at the hearing that as of August 31, 1986, Mountain was $42,000 in arrears to Kentucky West for the monthly gas purchases for part of March through August, 1986.

Mountain's original dates of maturity for the principal payments on the bank loans were March 9, 1986, for $22,000 and September 1, 1986, for $30,000. Mountain did not repay either of the loans. Mountain has proposed to include the interest expense on these loans in the revenue requirements determination. The

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[12] Case No. 9407, In the Matter of Mountain Utilities, Inc., Delinquent Purchased Gas Account with Kentucky West Virginia Gas Company, Final Order dated June 5, 1986.

banks, First Guaranty and First Commonwealth, have agreed to refinance the notes over a 3-year period with a stated interest rate of 11 1/2 percent subject to the Commission including the debts in the determination of revenue requirements.

In the July 6, 1982, Order in Case No. 8425 the Commission expressed its concern about the safe and adequate service to Mountain's customers and thus allowed the surcharge. The Commission, however, in granting the surcharge expected Mountain to remain current with Kentucky West. It was stated in the aforementioned Order that any amounts owed in excess of the $128,948, which were collected through the surcharge over an unapproved extension of the surcharge, will be the responsibility of the stockholders.

The Commission will not continue to allow Mountain a surcharge to cover interest expense or gas payment arrearages for its purchased gas expense. The Commission grants sufficient rates to operate the system efficiently (including purchased gas adjustments or automatic adjustments in gas supplier cost changes) and will not have the customers pay again and again for delinquencies arising from imprudent management. It is the Commission's opinion that the bank loans associated with the payment of past due gas purchases are the responsibility of the stockholders and not the customers. Therefore, the interest expense associated with the bank loans has not been included in the determination of revenue requirements.

The Commission concludes therefore that Mountain is entitled to increase its rates to produce an increase in annual operating revenues of $34,710, calculated as follows:

Adjusted Operating Expenses	$314,077
1.5 X Interest Expense	57,713
Subtotal	$371,790
Less:	
Adjusted Operating Revenue	$330,620
Adjusted Other Income	6,460
Revenue Requirement	$ 34,710

The Commission cautions Mountain that the margin above operating costs and interest payments is not intended to be used for the purposes of payment of extraordinary dividends nor for additional increases in salaries to stockholders employed in company operations. The adjusted margin will compensate for ordinary business risks and help facilitate the payments of the bank loans and may be applied to the Pratt Judgment settlement liability.

OTHER MATTERS

Based upon the financial audit report issued by the Commission staff for Mountain, certain practices were identified that are not in compliance with the Commission's regulations and Kentucky Revised Statutes. Mountain does not recalculate customer deposits pursuant to 807 KAR 5:006, Section 7(1); nor does Mountain pay or accrue interest annually on customer deposits as required by KRS 278.460. For each case Mountain responded that the additional administrative cost required to comply is not justified. Mountain is reminded that as a utility jurisdictional to the Commission it must comply with <u>all</u> Commission regulations, and in no instance can Kentucky Law be ignored.

The financial audit report also discovered that Mountain has been charging a $25.00 reconnection fee to customers whose service has been disconnected due to non-payment. However, the Commission notes that Mountain's present tariff on file allows only a $15.00 fee to be charged. Mountain filed additional information subsequent to the hearing which shows that approximately 45 customers have been charged this unapproved amount since the $25.00 fee was initiated on January 1, 1983, through August 31, 1985.

FINDINGS

The Commission, after consideration of the application and evidence of record and being advised, is of the opinion and finds that:

1. The proposed borrowing of $80,000 and the refinancing of $47,572 is for lawful objects within the corporate purposes of Mountain, is necessary and appropriate for and consistent with the proper performance of services to the public by Mountain, and will not impair its ability to perform these services.

2. The financing secured by Mountain for this project will be needed to pay for the work herein approved. Mountain's financing plan should, therefore, be approved.

3. The rates in Appendix A are fair, just and reasonable rates for Mountain and will produce annual gas sales revenue of approximately $360,880. This revenue when combined with other operating income of $4,450 and interest income of $6,460 will be

sufficient to allow Mountain to pay its allowable operating costs, service its allowable debt and provide a reasonable surplus.

4. The rates proposed by Mountain would produce revenue in excess of that found reasonable herein and, therefore, should be denied upon application of KRS 278.030.

5. Mountain should reclassify its unclassified Utility Plant to the appropriate accounts pursuant to the USoA and provide copies of the entries made to accomplish this within 30 days of the date of this Order.

6. With regard to depreciation expense, Mountain should extend the estimated lives on its meters and regulators to 20 years starting with the beginning of the test period and provide copies of the entries made to accomplish this within 30 days of the date of this Order.

7. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

8. Mountain should comply with 807 KAR 5:022 regarding the three projects referred to herein.

9. A construction schedule including materials for each project should be filed by Mountain at least 30 days prior to beginning construction.

10. Mountain should recalculate customer deposits as required by 807 KAR 5:006, Section 7(1).

11. Mountain should pay interest on customer deposits as required by KRS 278.460.

12. Regarding reconnection fees for customers whose service has been disconnected due to non-payment, Mountain should charge the fee as stated in its tariff on file with the Commission.

IT IS THEREFORE ORDERED that:

1. Mountain shall comply with Findings 1 and 2 and 4 through 6 herein as if each of these findings were also ordered.

2. The rates in Appendix A be and they hereby are approved for service rendered by Mountain on and after the date of this Order.

3. Within 30 days from the date of this Order Mountain shall file with the Commission the revised tariff sheets setting out the rates approved herein.

4. Mountain is granted a certificate of public convenience and necessity to proceed with the three projects referred to herein.

5. Mountain shall comply with 807 KAR 5:022 regarding the three projects referred to herein.

6. A construction schedule including materials for each project shall be filed by Mountain at least 30 days prior to the start of construction.

7. Mountain shall recalculate customer deposits pursuant to 807 KAR 5:006, Section 7(1).

8. Mountain shall immediately begin paying interest annually on customer deposits as required by KRS 278.460.

9. Within 30 days of the date of this Order Mountain shall file information with the Commission relating to how Mountain

proposes to refund to its customers the interest on their deposits that has not been paid.

10. Mountain shall not charge any amount for reconnection fees other than what is allowed in its tariff on file with the Commission.

11. Within 30 days of the date of this Order Mountain shall file a plan with the Commission to refund the overcharges to customers who paid the unapproved reconnection fee.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 30th day of October, 1986.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9546 DATED 10/30/86

The following rates and charges are prescribed for the customers served by Mountain Utilities, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order. The rates contained herein include all changes in rates through Case No. 8425-N.

RATES: Monthly

First	1 Mcf	$6.96 per Mcf
All Over	1 Mcf	6.20 per Mcf

Minimum Bill: $6.96
(When less than 1 Mcf is used)

The base rate for the future application of the purchased gas adjustment clause of Mountain Utilities, Inc., shall be:

	Commodity
Kentucky West Virginia Gas Company	$2.6062/Dth*

*Including Gas Research Institute Funding Charge of $0.0135 per Dth.